

# ADOPTION OF ACCRUAL ACCOUNTING IN LOCAL AUTHORITIES OF KEDAH DARUL AMAN

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## Abstract

*This study focuses on eleven municipal and district councils in Kedah Darul Aman, viewing whether local authorities adopt the accrual accounting in recording the income and expenditures and the problems faced by local authorities in adopting accrual accounting approach. The study found that only 5 of 11 (45%) local authorities in Kedah Darul Aman disclosed the use of accrual accounting in their application of accounting policies in the financial statements. Furthermore, there are certain items under income and expenditure that are still reported using cash basis. The nature of the items themselves, lacking in guidelines and also lacking in number of staff with experience and accounting education are part of the problems facing the local authorities in adopting the accrual accounting.*

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## 1.0 INTRODUCTION

From time immemorial, accounting for government and government agencies has been on cash basis. As the world changes with the fast pace in information technology and k-economy era, and the scarcity of resources, the government and public sector managers are more conscious of different ways to deliver services to achieve government policies and desired outcomes (IFAC 1996). This has also increase the demand for good governance especially in terms of transparencies and accountability.

Traditionally, cash accounting in public sector focused on the control of expenditure. The reform of the public sector has changed the traditional role of accounting to one that is focused on accountability and the efficient allocation of resources. This implies that accounting should concentrate upon outputs, performance measurement, efficiency, cost saving, productivity and performance measurement (Hoque and Moll, 2001; Broadbent and Guthrie, 1992). This in turn requires that new accounting technologies be employed such as planning program budgeting, accrual accounting, performance indicators and annual reporting mechanism (Hoque and Moll, 2001).

Currently the public sector is increasingly utilizing the accounting of private sector through a transition from cash based accounting principles towards a greater reliance on accrual based accounting principles (Klumpes, 2001). Accrual accounting will not bring benefits as of it but rather by providing richer information can bring benefits by improving the quality of decisions (IFAC 1994). In other words, accrual accounting if being adopted in public sector, provides a better quality of information and a better way of discharging accountability among the public sector managers.

Many countries like Australia, New Zealand and Canada have fully implemented this accounting reform in their government accounting. As for Malaysian context, according to Abdul Samad (2001), by looking at the experiences of the countries that had undergone reformation in the public sector, it could be concluded that the major demand for the push to accrual accounting is the growing demand for a greater transparency and better performances of the government sector and the companies controlled by the government.

## **2.0 MOTIVATION AND SIGNIFICANCE OF THE RESEARCH**

The government manages its financial economic activities through public accounting. Public accounting systems aim at authorizing and recording cash receipts and expenditures in respect of an agreed budget. In most countries, it is not consistently regulated.

There are two types of approach in public sector's financial reporting which are cash accounting and accrual accounting. In Malaysia, cash and modified cash is the current basis adopted by the Malaysian government. Malaysian government has also made a move in implementing the accrual accounting for public sectors (Abdul Samad, 2001). This is because accrual basis of accounting generates better quality of financial information and this information is necessary for the discharge of accountability and better decision making by internal management (Sutcliffe, 2001). Moreover, the traditional cash accounting system adopted in many countries is perceived as no longer satisfactory (Abdul Samad, 2001).

The Malaysian Cabinet through its Ministry of Finance, in October 2003 has directed the Accountants General's Office and Bank Negara Malaysia to study the possibility of adopting the widely practiced accrual accounting system, in place of the current cash accounting system (New Straits Times, October 21, 2003).

It is expected that the result of this research may provide useful information to regulators, the local authorities and also to the taxpayers. Hopefully, this study helps the regulators in giving the lights on the problems faced and experiences in adopting the accrual system. Thus, regulators may take positive actions towards enhancing the need for a better environment or regulations. For local authorities, this study provides comparison on current practice among local authorities in terms of adoption of accrual accounting. Perhaps, the local authorities will find some solutions in improving their reporting system. For tax payers, the result of this study will helps in providing a degree of accountability of the local authorities.

### **3.0 BACKGROUND**

#### **3.1 Problem Statements**

Malaysian government has also made a move in implementing the accrual accounting for public sectors (Abdul Samad, 2001). This is because accrual basis of accounting generates better quality of financial information and this information is necessary for the discharge of accountability and better decision making by internal management (Sutcliffe, 2001). Moreover, the traditional cash accounting system adopted in many countries is perceived as no longer satisfactory (Abdul Samad, 2001).

Lots of researches on accrual accounting have been carried out in western countries such as New Zealand, Australia, Finland, Greece, Denmark, Sweden and United States but few researches have been done in Malaysia on this area. Thus, this research is carried out to determine whether local authorities fully adopt the accrual accounting in recording the income and expenditures.

#### **3.2 Research Questions**

The main research question of this study is whether the local authorities of Kedah Darul Aman fully adopt the accrual accounting approach in recording income and expenditures. Thus, the following specific questions are related:

- 1) What is the current practice among local authorities in Kedah Darul Aman?
- 2) What are the problems faced by local authorities in adopting accrual accounting approach?

#### **3.3 Research Objectives**

The principle objective of this research is to examine the adoption of accrual accounting among the local authorities in the state of Kedah Darul Aman. Specifically, the research objectives are:

- 1) To examine the current practice among the local authorities in Kedah Darul Aman.
- 2) To identify the problems faced by the local authorities in adopting accrual accounting approach.

## **4.0 LITERATURE REVIEW**

### **4.1 Accrual vs Cash**

Cash accounting requires the record of inflows and outflows of cash. Accrual accounting as defined by Federal Accounting Standards Advisory Board, the recognition of the financial effects of transactions, events and circumstances in the period(s) when (they) occur, regardless of when cash is received or paid. It also requires revenue to be recognized in the period in which economic benefits can be measured reliably. Like wise, expenses are recognized when the consumption of goods is capable of reliable measurement (Hoque and Moll, 2001).

The main advantage of the cash system is simplicity, objectivity and the need to assess the compliance with cash budgets. However there are limitations like the system does not disclosed a true financial and economic position of the entity, no performance indicator and information on cost of services provided available for performance evaluation and control purpose (Montesinos and Bargues, 1996). In addition, the cash-based system also does not provide sufficient information to assess the government financial requirements like cash and revenue requirement to pay for past debts as well as future services, besides fail to provide the government complete information on all that they owe (Hillier, 1996).

### **4.2 Advantages of accrual accounting in government**

A number of researchers argue that cash based financial system and accrual accounting is both useful, however financial reports based on accrual accounting has its own advantages and significance to the modern government.

Accrual accounting in government provides better quality financial information and more comprehensive. This allows a better way of discharging accountability (Abdul Samad, 2001; Sutcliffe, 2001; Hoque and Moll, 2001) by extending the assessment of financial performance beyond the application of cash (OECD, 1993) and supports a better decision making by internal management (OECD, 1993; Sutcliffe, 2001) by providing information on the full cost of operations and the resources used to deliver services to the public (Hoque and Moll, 2001).

The accrual accounting system will also assist in the management of cash by highlighting assets and liabilities that will generate or consume cash (Abdul Samad, 2001). In terms of assets management, Mellor (1996) argues that under cash-based accounting system, there is a tendency to focus on whether or not to spend on new assets, whilst under accrual accounting system, the focus also extends to whether to retain or upgrade the existing assets. Thus, the accrual accounting reporting focuses decision makers on the broader range of options available in managing assets.

Other advantages offered by accrual accounting system are reducing double processing and reconciliation problems by integrating activities such as commitments or purchase order systems, payroll, fixed assets, creditors and debtors into one system (IFAC, 1994).

Accrual accounting also gives government the opportunity to minimize their cost through cost identification (Hoque and Moll, 2001).

Finally but not least, the accrual accounting system also facilitates a more efficient and effective resource management (OECD, 1993), reduction in staff responsible for routine accounting functions (IFAC, 1994), improves transparency, integrity and reliability of reported information (Mellor, 1996; Richardson, 1996). Thus, enable the government to produce useful and relevant financial information (Richardson, 1996).

### **4.3 The Country Experiences**

In New Zealand, the public sector experienced a major reform in the late 1980s and early 1990s. This reform changed public sector management from cash based accounting to a performance and accountability-based regime, using accrual based accounting. The frustrating operating environment in early 1980s plus with confrontation of economic problems in 1984 has lead to the development of a comprehensive and integrated financial management system (IFAC, 1994; Richardson, 1996). The main concept for the change, according to Abdul Samad (2001) is that the establishment of accountability relationship, recognizing the interests of the government as owner of departments and as a purchaser of outputs and outcomes and greater chief executive controls over input.

New Zealand finally legislated the Public Finance Act 1989 that aligned the public sector and private sector accounting practice (Abdul Samad, 2001). The necessary amendment was made in 1992 with a better defined Crown entities and State-owned Enterprises in 1992 (IFAC, 1994). Finally, the first comprehensive set of accrual based annual financial statements of the Government of New Zealand was tabled in the Parliament in October 1992 (OECD, 1993).

In Australia, the government has announced that the Federal Government departments would move to financial reporting on accrual basis on November 1992 (OECD, 1993). A range of social, political, economic and technological pressures had forced the government to become more effective, efficient and accountable for the use of publicly generated funds (Ryan, 1998; Hoque and Moll, 2001).

Australia was said to apply the 'domino theory' in its campaign to popularise accrual accounting, by first targeting public trading enterprises, then local government, followed by government departments and finally the government as a whole (Walker, Clarke and Dean, 1999). It commenced the mandatory accrual reporting for all its Commonwealth Agencies from the 1994-1995 financial years. The first audited whole of government 1996-1997 annual financial statement was tabled in 1997 (Abdul Samad, 2001). The reform in governmental financial reporting in Australia have been directed toward improving the efficiency and the effectiveness of the public sector and accountability to the Government and Parliament (OECD, 1993) particularly the politicians, policy making agencies and operational managers (Mellor, 1996).

Hillier (1996) reported that the Canadian Government in 1980s has significantly changed their financial reporting practice from cash based accounting to accrual with recommendation by the Public Sector Accounting and Auditing Board (PSAAB) and legislative auditors who convinced the government that the cash basis of accounting failed to provide them with complete and accurate information for decision making and accountability.

According to Wynne (2003), accrual accounting was used in English local authorities from around 1850s and it was first introduced in some local authorities in Switzerland in 1940s and all agreed to introduce it in 1977.

#### **4.4 The Malaysian Context**

In Malaysia, the Government through its Accountant General Department manages the nation's accounting and financial aspects in accordance with the Financial Procedure Act 1957 (revised 1972), Unclaimed Monies Act 1965 and the Pension Fund Act 1991. As far as local authorities are concerned, they are governed by the Local Government Act 1976, also known as Act 171. Clause 54 (4) of the act specifies that the "annual statement shall be prepared in such form and shall contain such information as may be required by the State Authority".

Section 53 of Local Government Act 1976 states that "The local authority should keep proper records and accounts, and record all the transactions incurred by the local authority, and that these records and accounts should be available for inspection at any time by any of the councilors of that local authority with the permission of the Mayor or President." However, those legislative provisions do not clearly delineate the mode of accounting to be adopted (Abdul Samad, 2001). According to Siti Maslamah (2001) the accounts of most local authorities are prepared on an accrual basis based on Generally Accepted Accounting Principles (GAAP) and International Accounting Standards (IAS).

In Malaysia, there is no such body similar to the United States of the America's Government Accounting Standard Board or the Public Sector Accounting Standards Board of Australia to look into the pronouncement or guidelines in formulation of standards applicable to the local environment (Abdul Samad, 2001). Mahamad Tayib (1994) revealed that at least four different accounting standards have been adopted and used by Malaysian local authorities. They are International Accounting Standards (IAS), guidance issued by the Ministry of Housing and Local Government (GMHLG), Federal Treasury Circular (FTC) and self created accounting practices (SCAP).

According to Siti Maslamah (2001), the local authorities can implement with modifications, the Standard Accounting System for Government Agencies (SAGA) that was launched in early 1996. It is a standard accounting package based on accrual accounting formulated for the Federal Statutory Bodies.

However, the Accountant General's Department through The Ministry of Housing and Local Government and Malaysian Administrative Modernisation Management Planning

Unit (MAMPU) is taking the initiative to develop a standard accounting system for local authorities (Siti Maslamah, 2001).

The financial reform experiences in countries like New Zealand and Australia, demonstrates that, such change is not only possible, but can also be highly successful. As compared to Malaysian environment, Abdul Samad (2001) is confident that it is possible to implement such reforms. Privatisation of Malaysian government projects has proved that the transition of to accrual accounting is possible. This pertains to the valuation of assets in changing the government enterprise to that of a company limited by shares.

Therefore, there is a need to know the current practice in Malaysian Government financial reporting, and local authority is seems to be the best agency to be taken as a starting point.

## **5.0 RESEARCH METHODOLOGY**

This section outlines the methodology adopted for this study.

### **5.1 Sample Selection**

The samples for this study composed of all municipal and district councils in Kedah Darul Aman. They were:

1. Majlis Perbandaran Kota Setar (changed to Majlis Bandaraya Alor Setar in 2003)
2. Majlis Perbandaran Sungai Petani
3. Majlis Perbandaran Kulim
4. Majlis Perbandaran Langkawi Bandaraya Pelancongan
5. Majlis Daerah Kubang Pasu
6. Majlis Daerah Baling
7. Majlis Daerah Yan
8. Majlis Daerah Padang Terap
9. Majlis Daerah Sik
10. Majlis Daerah Bandar Baharu
11. Majlis Daerah Pendang

### **5.2 Data Collection**

The data collection method used for this research was an analysis of annual reports and interviews. This study focused on accounting year 2001 for analysis purposes. Firstly, the annual reports were collected from all samples and the data was analyzed by comparing the current practice of the accrual accounting in income statement items of all samples. The data from annual report were obtained using a score sheet designed to measure the application of accrual accounting in each of the items in income statement. This was done by comparing the items with accounts receivable, accounts payable and notes to the account, specifically on the fixed assets schedules. Items that presented in one of the above account/notes were classified as “disclosed” indicating that the accrual accounting was applied in such items. Otherwise, the items were noted as ‘silent’. Items that were not existed in any statement were classified as ‘no item’.

Secondly, after analyzing the data in the annual report, then face-to-face interviews were conducted. The interviews had contributed two major tasks, first was to confirm the findings in the annual report; and secondly, it helped in obtaining further information on problems facing the local authorities in adopting the accrual basis. The interviews were conducted on five (5) local authorities, representing the most, medium and least adoption of accrual accounting. The interviewees were either the Accountants or Assistant Accountants who serves the local government in a range from 2 to 26 years.

### 5.3 Data Analysis

Descriptive statistic was used to describe the data collected for this exploratory study in nature. Due to that, simple analysis such as mean, ranking and percentage were applied in order to meet the objectives of the study.

## 6.0 RESULTS AND DISCUSSIONS

### 6.1 Types of Local Authority

The samples of this study includes the local authorities in the State of Kedah Darul Aman totaled to 11 (eleven) local authorities as at year 2001. Table 1 shows the classification of all the samples according to the type or size of local authorities in Kedah Darul Aman. There are four Municipal Councils (36%) and seven District Councils (64%) in the State of Kedah. This result might be different as in year 2003, because Majlis Perbandaran Kota Setar has been changed to Majlis Bandaraya Alor Setar.

**Table 1**  
**Type of local authorities in Kedah Darul Aman (n=11)**

| <b>Local authorities</b> | <b>Frequency</b> | <b>Percentage</b> |
|--------------------------|------------------|-------------------|
| Municipal Council        | 4                | 36                |
| District Council         | 7                | 64                |
| <b>Total</b>             | <b>11</b>        | <b>100</b>        |

### 6.2 Adoption of Accrual Accounting

According to MASB 1 Presentation of Financial Statement paragraph 15, a fair presentation of financial statement was achieved by among others, the presentation of information including accounting policies, in a manner which provides relevant, reliable, comparable and understandable information. Table 2 shows the disclosure of accrual accounting application in their accounting policies which was noted under notes to the accounts.

**Table 2**  
**Disclosure of Accrual Accounting Application in the Accounting Policies (n=11)**

| <b>Local Authority</b> | <b>Disclosed (Percent)</b> | <b>Silent (Percent)</b> |
|------------------------|----------------------------|-------------------------|
| Municipal Council      | 1 (9.09)                   | 3 (27.27)               |
| District Council       | 4 (36.36)                  | 3 (27.27)               |
| <b>Total</b>           | <b>5 (45.45)</b>           | <b>6 (54.55)</b>        |

Only five local authorities which contributed to 45.45% of local authorities in Kedah, which consists of one (1) Municipal Council and four (4) District Council that disclosed the use of accrual of accounting in preparing their financial statements in their notes to the accounts. The other six (6) local authorities, contributed to 54.55% were remain silent about using of accrual basis in preparation of their financial statements.

Based on the above result, it can be concluded that almost half of the local authorities disclosed the application of accrual accounting in their accounting policies. In the same time, the other half just remain silent. This shows that there is a move towards accrual accounting in financial reporting among local authorities. The move towards accrual accounting shows there is a demand for a greater transparency and better performances of government sector and companies controlled by the government (Abdul Samad, 2001). However, the remaining local authorities remain silent due to general or unclear guidelines or regulations on the preparations of financial statements of local authorities. It depends on the judgment or justification of each local authority on how to adopt the accrual accounting. Therefore, this result is consistent with Abdul Samad (2001), where legislative provisions do not clearly delineate the mode of accounting to be adopted.

Table 3 shows the adoption of accrual accounting on income and expense items by local authorities. It shows that accrual accounting has been fully applied by all local authorities in items like assessment income, rental income, professional fees expense and depreciation expense. Whereas, there was no indication of accrual applications by all local authorities in items like license and registration, sales of goods and fine and compound.

For items like income from advertisement, services, emolument expense and local grant which were under expenses items; about 72.7% to 81.8% of local authorities remain silent. The rest of 18.2% to 27.3% has disclosed the accruals in their statements, except for income for advertisement where 18.2% did not have such item in their statement. As far as interest on loan expense and loan written off were concerned, only one local authority has disclosed the accruals in its financial statement, the rest of the local authorities did not show such item.

The results show that the levels of adoption of accrual accounting, especially on the income and expenses items are still considered low. Only four (4) items were 100% using

the accrual basis, where as the remaining were categorized as silent or 'no item' category. The findings evidenced that local authorities are far behind in adopting accrual accounting. This findings support the evidences made by Abdul Samad (2001) that there was nobody that look at the pronouncement or guidelines in formulation standards applicable for local authorities.

**Table 3**  
**Adoption of Accrual Accounting on income and expense items (n=11)**

|                                  | <b>Disclosed</b> | <b>Silent</b>    | <b>No Item</b>   |
|----------------------------------|------------------|------------------|------------------|
|                                  | <b>Frequency</b> | <b>Frequency</b> | <b>Frequency</b> |
|                                  | <b>(Percent)</b> | <b>(Percent)</b> | <b>(Percent)</b> |
| <b>Income:</b>                   |                  |                  |                  |
| Assessment                       | 11 (100)         | -                | -                |
| License/Registration             | -                | 11 (100)         | -                |
| Advertisement                    | -                | 9 (81.8)         | 2 (18.2)         |
| Service                          | 3 (27.3)         | 8 (72.7)         | -                |
| Sales of goods                   | -                | 11 (100)         | -                |
| Rental                           | 11 (100)         | -                | -                |
| Interest Received                | 10 (90.9)        | -                | 1 (0.09)         |
| Fine and compound                | -                | 11 (100)         | -                |
| Refund and unclaimed monies      | -                | 5 (45.5)         | 6 (54.5)         |
| Grant and contribution           | 3 (27.3)         | -                | 8 (72.7)         |
| Gain on disposal of fixed assets | 5 (45.5)         | 6 (54.5)         | -                |
| Other income                     | 6 (54.5)         | -                | 5 (45.5)         |
| <b>Expenses:</b>                 |                  |                  |                  |
| Emolument                        | 2 (18.2)         | 9 (81.8)         | -                |
| Services and supplies            | 6 (54.5)         | 5 (45.5)         | -                |
| Local grant                      | 3 (27.3)         | 8 (72.7)         | -                |
| Professional fees                | 11 (100)         | -                | -                |
| Provision for doubtful debt      | 5 (45.5)         | 6 (54.5)         | -                |
| Depreciation                     | 11 (100)         | -                | -                |
| Interest on loan                 | 1 (9.1)          | -                | 10 (90.9)        |
| Loss on disposal of fixed assets | 5 (45.5)         | 6 (54.5)         | -                |
| Loan written off                 | 1 (9.1)          | -                | 10 (90.9)        |

Table 4 shows the ranking of application of accruals in income statement items. Among all income items, assessment and rental ranked the highest with 100% application, followed by interest received item with 90.9%. For items like license/registration, advertisement, sales of goods, fine and compound, refund and unclaimed monies, there was no disclosure of any accruals. On the other hand, professional fees expense ranked the highest among all expenses items. Items like interest on loan and loan written off

shows the least disclosure of accruals with only 9.1% representing by only one local authority.

Based on the results above, we can conclude that the local authorities were not been able to collect their deferred income especially from the assessment and rental. Meanwhile, advertisement, fine and compound, refund and unclaimed monies practiced fully cash basis in their transactions. This is due to the nature those items where cash basis is most preferred as it offers simplicity and objectivity (Montesinos and BARGUES, 1996). Allocation of those items according to the period earn requires more effort. However, the cash basis did not provide sufficient information and fail to provide information needed to the government.

**Table 4**  
**Ranking of Adoption of Accrual Accounting for income and expense items (n=11)**

| Item                             | Rank | Frequency | Percentage |
|----------------------------------|------|-----------|------------|
| <b>Income:</b>                   |      |           |            |
| Assessment                       | 1    | 11        | 100        |
| Rental                           | 1    | 11        | 100        |
| Interest Received                | 3    | 10        | 90.9       |
| Other income                     | 4    | 6         | 54.5       |
| Gain on disposal of fixed assets | 5    | 5         | 45.5       |
| Service                          | 6    | 3         | 27.3       |
| Grant and contribution           | 6    | 3         | 27.3       |
| License/Registration             | 7    | 0         | 0          |
| Advertisement                    | 7    | 0         | 0          |
| Sales of goods                   | 7    | 0         | 0          |
| Fine and compound                | 7    | 0         | 0          |
| Refund and unclaimed monies      | 7    | 0         | 0          |
| <b>Expenses:</b>                 |      |           |            |
| Professional fees                | 1    | 11        | 100        |
| Services and supplies            | 2    | 6         | 54.5       |
| Provision for doubtful debt      | 3    | 5         | 45.5       |
| Loss on disposal of FA           | 3    | 5         | 45.5       |
| Local grant                      | 5    | 3         | 27.3       |
| Emolument                        | 6    | 2         | 18.2       |
| Interest on loan                 | 7    | 1         | 9.1        |
| Loan written off                 | 7    | 1         | 9.1        |

Table 5 shows the depreciation rates applied by local authorities for all their fixed assets. Nearly 91% representing 10 local authorities use 1%-5% rates for depreciation of buildings, followed by one local authority that use 6%-10%. Meanwhile for vehicles and machineries, all local authorities apply 16%-20% depreciation rate. For equipment and

furniture, 81.8% of local authorities use a range of 6%-10% and the rest use the range of 11%-15% as their depreciation rate. Only one local authority has recorded temporary building and depreciated at the rate of 5%.

Based on the results revealed, 100% local authorities adopted accrual accounting in allocating the depreciation expenses. The high level of compliance may be due to the Circular circulated by the local council. Usually, the depreciation rates were decided and agreed in the meetings. Thus, all the local authorities need to comply with the Circular or requirements. The results supported the findings made by OECD (1993); IFAC (1994); Mellor (1996) and Richardson (1996) that accrual accounting system facilitates a more efficient and effective resource management, improves transparency, integrity and reliability of reported information and enable the government to produce useful and relevant financial information.

**Table 5**  
**Depreciation Rates of Fixed Assets (n=11)**

| <b>Rate</b>            | <b>1-5%</b>                    | <b>6-10%</b>                   | <b>11-15%</b>                  | <b>16-20%</b>                  |
|------------------------|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| <b>Items</b>           | <b>Frequency<br/>(Percent)</b> | <b>Frequency<br/>(Percent)</b> | <b>Frequency<br/>(Percent)</b> | <b>Frequency<br/>(Percent)</b> |
| Buildings              | 10 (90.9)                      | 1 (9.1)                        | -                              | -                              |
| Vehicles & machineries | -                              | -                              | -                              | 11 (100)                       |
| Equipment & Furniture  | -                              | 9 (81.8)                       | 2 (18.2)                       | -                              |
| Temporary Buildings    | 1 (9.1)                        | -                              | -                              | -                              |

Table 6 in the appendix shows the results of application of accrual accounting on income statement items in all local government under this study. This revealed that the application of accrual accounting is vary among local authorities. Due to this, face to face interviews were conducted with local authorities that are categorized as most, medium and least adoption of accrual accounting.

Table 7 below, presents the results from the interviews conducted with five local authorities which representing the most, medium and least adoption of accrual accounting. This table focused mainly on the application of accrual concept in income statement items. The results revealed that the highest score were the assessment tax and rental which were categorized under revenue. Meanwhile the highest score for expenses items were the professional fees and depreciation. These items were found to be fully accrual adopted by those five local authorities. This is in line with the contention made by Abdul Samad (2001) that Malaysian government has also made a move in implementing the accrual accounting for public sectors. The traditional cash accounting system adopted in many countries is perceived as no longer satisfactory.

**Table 7**  
**Application of Accrual or Cash Accounting for Income Statement Items (n=5)**

| Items disclosed in profit & loss by 5 local authorities | Frequency |            |
|---|-----------|------------|
|   | Accrual   | Cash basis |
| <b>Income:</b>  |           |            |
| Assessment  | 5         | 0          |
| Rental  | 5         | 0          |
| Services  | 4         | 1          |
| Sale of goods   | 4         | 1          |
| Fine and compound                                       | 4         | 1          |
| Local grant   | 4         | 1          |
| Refunds   | 4         | 1          |
| Earnings from local investment                          | 4         | 1          |
| Advertisement   | 3         | 2          |
| Other receipt   | 3         | 2          |
| Miscellaneous   | 3         | 2          |
| License/ Registration                                   | 2         | 3          |
| Non revenue item  | 2         | 3          |
| Grant and contribution                                  | 1         | 4          |
| <b>Expenses:</b>  |           |            |
| Professional fees                                       | 5         | 0          |
| Depreciation  | 5         | 0          |
| Local grant   | 4         | 1          |
| Loan written off  | 3         | 2          |
| Gain on disposal of fixed assets                        | 3         | 2          |
| Emolument   | 1         | 4          |
| Services and supplies                                   | 1         | 4          |
| Provision for doubtful debt                             | 1         | 4          |
| Interest on loan  | 1         | 4          |

Table 7 also shows that there were items that were recorded under cash basis by most of the local authorities. The items were grant and contribution for revenue and emolument, services and supply, and interest on loan for expenses items. Moreover, study found that the provision for doubtful debt has not been applied in most of the local authorities. Based on the interview carried out, the results strongly evidenced that there were certain items in the income statement that still used cash basis. This is due to a few reasons and difficulties facing the local authorities in applying accrual accounting in their reporting.

### **6.3 Problems in Adopting Accrual Accounting**

Lack of clear guidelines by regulator is one of the main problems where the mode of accounting to be adopted is not clearly stated by most of the legislative provisions.

Among the legislative provisions that are made through Financial Procedure Act 1957 (revised 1972), Unclaimed Monies Act 1965, Pension Fund Act and Local Government Act 1976, generally states the need to keep proper records and made available for inspection. Treasury Circular no. 15 (1994) provides a clear guideline on preparation and presentation of Financial Statement, however, the guideline is only for federal statutory bodies.

Small number of staff with accounting background in local authorities is another reason contributes to the problems in adopting accrual accounting. A clear understanding and consciousness in accounting plays an important role as this reflects the recording and reporting the financial position of the local authorities themselves. For instance, the recognition of revenue from assessments, rentals, fine and compounds requires a clear understanding and efforts from staff. Lacking in this will distort the full adoption of accrual accounting. On the other hand, less training that can provide experienced and hands on staff also contributes to the less adoption of accrual accounting in local authorities.

Furthermore, there few items that are deal in cash, for example, sales of goods, license and registrations as well as the payment of salaries and emoluments. Due to this nature, the application of cash basis is most preferred for a matter of simplicity and objectivity.

## **7.0 CONCLUSION, LIMITATION AND FUTURE RESEARCH**

Overall, there is a positive shift from cash basis towards accrual accounting by local authorities in Kedah Darul Aman. However, due to unclear guidelines and a lot of judgments being made by local authorities, so the adoption of accrual accounting is still not 100% successful. Thus, better guidelines must be provided to the local authorities, so that it helps the preparers to disclosed better financial information for the users, regulators and better decision making can be achieved.

The limitation of this research is that the coverage of the sample was only local authorities for Kedah Darul Aman. There are only eleven local authorities in Kedah Darul Aman. This indicates that the number of sample was too small. Meanwhile for the interviews being carried out, we only select five local authorities which were categorized as the most, medium and the least adoption of accrual accounting. All these factors might lead to biasness. Thus, the findings cannot be generalized to all 149 local authorities in Malaysia.

For future research, it is suggested that the researchers extended the sample size to include all local authorities in Malaysia. Furthermore, semi-structured questionnaire can be attached together with the interview in order to get useful response from the staffs on the adoption of accrual accounting. Hopefully by incorporating all local authorities as the sample, it can also help regulators to monitor the level of accrual adoption of local authorities in Malaysia.

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APPENDIX

Table 6  
Application of Accrual for Income Statement Items by Local Authorities

|   | LA1       | LA2       | LA3      | LA4      | LA5      | LA6       | LA7      | LA8      | LA9      | LA10     | LA11     | Total |
|---|-----------|-----------|----------|----------|----------|-----------|----------|----------|----------|----------|----------|-------|
| <b><u>Income:</u></b>                               |           |           |          |          |          |           |          |          |          |          |          |       |
| Assessment  | ✓         | ✓         | ✓        | ✓        | ✓        | ✓         | ✓        | ✓        | ✓        | ✓        | ✓        | 11    |
| License/Registration                                |           |           |          |          |          |           |          |          |          |          |          | 0     |
| Advertisement                                       |           |           |          |          |          |           |          |          |          |          |          | 0     |
| Service   | ✓         |           | ✓        | ✓        |          |           |          |          |          |          |          | 3     |
| Sales of goods                                      |           |           |          |          |          |           |          |          |          |          |          | 0     |
| Rental  | ✓         | ✓         | ✓        | ✓        | ✓        | ✓         | ✓        | ✓        | ✓        | ✓        | ✓        | 11    |
| Interest Received                                   | ✓         | ✓         |          | ✓        | ✓        | ✓         | ✓        | ✓        | ✓        | ✓        | ✓        | 10    |
| Fine and compound<br>Refund and unclaimed<br>monies |           |           |          |          |          |           |          |          |          |          |          | 0     |
| Grant and contribution                              |           |           |          |          | ✓        | ✓         |          |          |          |          | ✓        | 3     |
| Gain on disposal of fixed<br>assets                 | ✓         | ✓         | ✓        |          |          | ✓         | ✓        |          |          |          |          | 5     |
| Other income  |           | ✓         |          |          | ✓        |           | ✓        | ✓        | ✓        |          | ✓        | 6     |
| <b><u>Expenses:</u></b>                             |           |           |          |          |          |           |          |          |          |          |          |       |
| Emolument   | ✓         |           |          | ✓        |          |           |          |          |          |          |          | 2     |
| Services and supplies                               | ✓         |           |          | ✓        | ✓        | ✓         | ✓        |          |          |          | ✓        | 6     |
| Local grant   |           | ✓         |          | ✓        | ✓        |           |          |          |          |          |          | 3     |
| Professional fees                                   | ✓         | ✓         | ✓        | ✓        | ✓        | ✓         | ✓        | ✓        | ✓        | ✓        | ✓        | 11    |
| Provision for doubtful<br>debt                      | ✓         | ✓         |          |          |          | ✓         |          | ✓        |          | ✓        |          | 5     |
| Depreciation  | ✓         | ✓         | ✓        | ✓        | ✓        | ✓         | ✓        | ✓        | ✓        | ✓        | ✓        | 11    |
| Interest on loan                                    | ✓         |           |          |          |          |           |          |          |          |          |          | 1     |
| Loss on disposal of fixed<br>assets                 | ✓         | ✓         | ✓        |          |          | ✓         | ✓        |          |          |          |          | 5     |
| Loan written off                                    |           |           | ✓        |          |          |           |          |          |          |          |          | 1     |
| <b>Total</b>  | <b>12</b> | <b>10</b> | <b>8</b> | <b>9</b> | <b>9</b> | <b>10</b> | <b>9</b> | <b>7</b> | <b>6</b> | <b>6</b> | <b>8</b> |       |

Note: LA – Local Authority